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¶1. (U) Provided below is Embassy Buenos Aires' Economic and Financial Review covering the period December 19 - 24, 2008. The unclassified email version of this report includes tables and charts tracking Argentine economic developments. Contact Econoff Chris Landberg at landbergca@state.gov to be included on the email distribution list. This document is sensitive but unclassified. It should not be disseminated outside of USG channels or in any public forum without the written concurrence of the originator. It should not be posted on the internet.

Highlights

-- President announces Ag Sector stimulus program
-- GoA ups payments to low-income workers and retirees
-- Congress amends income tax legislation to promote consumption and growth
-- Congress approves Tax Moratorium and Capital Repatriation bill
-- Fitch downgrades Argentina's sovereign credit rating
-- ANSES auctions long-term deposits to banks
-- Consumer confidence index decreases 2.2% m-o-m, down 28% for year
-- GoA 2009 Financial Program manageable, according to local analysts

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New GoA Economic Stimulus Programs

President announces Ag Sector stimulus program
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¶2. (SBU) On December 22, President Cristina Fernandez de Kirchner continued her recent trend of making one major government stimulus plan announcement each week, this time presenting a package of measures to support the agricultural sector (and also increasing payments to low-income workers -- see next item). This followed her December 15 decision to expand her previously announced public works program from US$ 21 billion to approximately US$ 31 billion and increase payments to retirees (see next item), her December 4 announcement of US$ 3.9 billion in credit subsidies and export tax cuts, and her November 25 announcement of a tax incentive package and the original public works program. Details of the December 22 proposal:

-- The President confirmed her December 4 proposal to reduce the export tax on wheat and corn by five percentage points each (to 23% for wheat and 20% for corn). In addition, she announced that when historical production averages are

exceeded (13 million tons for wheat and 15 million tons for corn), export taxes will decrease by one additional percentage point for large producers (2,500 tons of wheat, 5,000 tons of corn), two points for medium-size producers (500-2,500 tons wheat; 1,000 - 5,000 tons corn), and five points for small producers (up to 500 tons wheat and 1,000 tons corn) for each additional million tons produced. (Note: Producers are unlikely to see these further cuts, as grain production is expected to fall significantly during this marketing season due to the drought, export restrictions, and maximum prices.)
-- Dairy bull calves: the GOA will build five feed-lot operations capable of servicing a total of 200,000 head to produce 100,000 tons of beef for the export market.
-- Fruit and Vegetables: the export tax for pears, apples, peaches, citrus fruit, grapes, blueberries, strawberries, onions, frozen potatoes, beans, and pulses will be reduced by 50% (fresh deciduous fruit and stone fruit currently pay a 10% export tax, and citrus fruit and vegetables, 5%).
-- Financial assistance: $230 million will be devoted to producers who were affected by the recent drought.

¶3. (SBU) Ag Sector Reaction: Producers expected a reduction of the export tax on soybeans, but were disappointed when oilseeds (including soybeans and sunflower) were not included in the announcement. The Liaison Commission (representing the four main farmer organizations) strongly criticized the announcements and threatened "direct action" (i.e., protests on the highways). Road blockages occurred this week in the Province of Entre Rios, and producer protests are being organized by farm organizations throughout the country for the post-holiday period.

GoA ups payments to low-income workers and retirees
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¶4. (SBU) In addition to the Ag sector measures, the President also announced December 22 an ARP 200 (US$ 58) lump sum payment for all private and public employees earning the minimum salary (ARP 1240 or US$ 360 per month), to be implemented before January 6, 2009. This measure will impact more than 600,000 employees. In addition, the GoA will increase welfare payments by ARP 150 (US$ 43) to Family Program beneficiaries and disabled pensioners, and ARP 100 (US$ 29) to Head of Households Program beneficiaries. This program will affect approximately 2.1 million people, and the GoA will implement it before December 29. Local press has reported rumors that some in the GoA believe that provincial governments should help fund these salary and welfare benefit increases. In addition, the President announced December 15 that the over six million retirees in Argentina will receive an ARP 200 US$ 58) lump-sum payment, on top of year-end bonuses. This will increase public expenditures by approximately US$ 350 million in December 2008, as estimated by Economist Miguel Angel Broda in his weekly report, "Carta Economica." The GoA hopes recipients will devote the ARP 200 entirely to consumption, thereby sustaining domestic demand. However, many analysts believe the measure will have a limited impact, dissipating by mid-January.

Fiscal

Congress amends income tax legislation to promote consumption and growth
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¶5. (SBU) In an unusually rapid procedure, the Argentine Senate unanimously approved the GoA's proposed amendments to income tax legislation on December 18, one day after the lower house had unanimously passed it, and only three days after the GoA sent the bill to Congress. The bill modifies the so-called "Tablita de Machinea," named after Economy Minister Machinea, who introduced the scheme in 2000. (Note: the "tablita" established the legal income tax deductions

available for taxpayers. Available deductions decreased as income levels increased, with zero deductions allowed for annual incomes over ARP 221,000, or about US$ 64,000. The occasional result was that after-tax income for taxpayers earning over the maximum amount could be lower than for some earning less, creating a distortion in the labor market.) The approved amendment lowers the effective income tax rate, mainly for middle and higher income employees, since it removes the provision that limits income tax deductions.

¶6. (SBU) Private analysts estimate the measure will reduce income tax collection by ARP 2.5 billion per year (US$ 725 million). While the GoA took this action to foster greater consumption, private analysts argue that higher earners are inclined to save or purchase foreign currency instead of consuming. Therefore, they expect it will not have much effect, and suggest instead finding ways to increase the disposable income of low-earners -- for example, by lowering the VAT -- who have a higher propensity to consume. Economia y Regiones, a think tank specializing on provinces, notes that the amendment will reduce GoA automatic transfers to provinces by about US$ 380 million per year, since income tax revenue is almost equally shared between the GoA and provinces, under Argentina's "co-participation" laws. Interestingly, not one congressional representative from the provinces mentioned or objected to this during floor debates.

Congress approves Tax Moratorium and Capital Repatriation bill
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¶7. (SBU) On December 18, the Senate approved the GoA's bill to provide tax incentives to foster job creation and encourage the repatriation of funds held abroad, with a vote of 42 in favor and 27 against. Given that the Chamber of Deputies had already approved the bill (see November 28 and December 10 Economic and Financial Review for further details), it will enter into force after publication in the Official Gazette. A prominent element of this law is the Capital Repatriation chapter, which has generated concern both locally and internationally over whether it may facilitate money laundering. The bill as approved exempts any party taking advantage of this opportunity from having to verify the origin of the money or assets repatriated into the local financial system. (Note: however, Article 40 of the law does state that the law does not relieve financial or non-financial entities from their legal obligations under

Argentina's anti-money laundering or counter-terrorism finance laws.)

Finance

Fitch downgrades Argentina's sovereign credit rating
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¶8. (SBU) On December 18, Fitch Rating Agency downgraded Argentina's long-term local currency issuer rating to "B minus" from "B," its country ceiling to "B" from "B plus," and its performing bonds in foreign and local currency governed by Argentine law to "B minus" from "B." Fitch cited challenging fiscal and external financing requirements and Argentina's limited options to deal with them, as well as decelerating real GDP growth and falling commodity prices, as reasons for the downgrade. Fitch acknowledged that the recent nationalization of the private pension funds will help the GoA cover debt obligations over the next twelve to eighteen months, but argued that it will also increase long-term costs. Fitch further warned of even greater challenges for policy makers in the event of a sharper than anticipated economic slowdown or increased capital flight.

¶9. (SBU) The Fitch downgrade is just the latest from the credit agencies. On October 31, S&P lowered Argentina's foreign and local currency sovereign credit ratings to B-/C

from B/B with stable outlook. This followed S&P's August downgrade for both foreign and local currency ratings from B to B. Also in August, Moody's changed the outlook on Argentina's B3 foreign and local currency government bond ratings from positive to stable. In late October, Moody's expressed concerns over the GoA's nationalization of the private pension system, but noted that this would not impact Argentina's B3 rating because it already reflects a high probability of financial distress. Rating agencies have also downgraded their debt ratings for several Argentine provinces and private companies over the course of 2008.

ANSES auctions long-term deposits to banks

¶10. (SBU) On December 16, GoA social security agency ANSES successfully auctioned ARP 600 million in deposits to banks operating in Argentina. Through the auction mechanism, banks bid on fixed-term deposits from ANSES at 11% for one year. In return, the winning bidders pledged to lend the funds at below-market rates to small- and medium-sized businesses at 14.2%, to consumers at 15.4%, and to car buyers at 16.25%. This compares to average market interest rates of 35%, 33%, and 22%, respectively. This initiative is part of a broader plan to auction a total of about US$ 2.5 billion in fixed-term deposits from the stock of private sector pension funds (AFJPs) that the GoA recently nationalized. Chief of Cabinet Sergio Massa and ANSES Director Amado Boudou described the auction as a success, since demand was almost three times the auctioned amount (ARP 1.6 billion). However, the majority of participating banks were state-owned, and they walked away with 80% of the allocated funds. The GoA's stated strategy is to foster lower interest rates and stimulate lending to individuals and small companies in order to mitigate the local credit squeeze and promote increased spending and investment. ANSES is scheduled to hold the next auction, for an additional ARP 600 million, this week.

Macro Outlook

Consumer confidence index decreases 2.2% m-o-m, down 28% for year
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¶11. (SBU) Di Tella University's consumer confidence index slid for the third consecutive month in December, decreasing 5.3% m-o-m to 37.1 points. The index accumulated a decrease of 28% for the whole year, after starting January at 55.0 (shortly after President Cristina Fernandez de Kirchner took office). It dipped to 40 in June in the middle of the farm conflict and looks to close the year at a level not seen since December 2002. In December, all three index components declined: 1) consumer willingness to purchase durable goods and real estate decreased 6.7%; 2) consumer sentiment towards the macroeconomic environment decreased 3.5%; and 3) consumers' perception of personal economic well-being decreased 6.3%. According to analysts, this sharp deterioration in consumer sentiment reinforces the view that the economy will continue to slow rapidly in the months

ahead, despite recent GoA measures designed to promote consumption and credit. (Note: The index is based on surveys of individuals and consumers' willingness to purchase durable goods, houses and cars.)

GoA 2009 Financial Program manageable, according to local analysts
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¶12. (SBU) High yields in Argentine sovereign bonds (over 40% for dollar-denominated short duration bonds, and close to 50% for peso-denominated short duration bonds) reflect market concerns over the GoA's capacity and willingness to pay its debts. Post surveyed three well-known private economic consultancies to get their views on the GoA's ability to meet 2009 financial obligations. Despite minor differences in

their estimates, all three groups consider the GoA's 2009 financial program to be manageable, with the GoA's financing gap ranging from a low of $1.2 billion to $3.5 billion, depending on macro and available refinancing assumptions. In the opinion of these analysts, the market is overreacting to the possibility of an Argentine default. Highlights of the analysis from FIEL (Fundacion de Investigaciones Economicas Latinoamericanas), Bein Asociados, and Miguel Kiguel's Econviews follow:

-- Primary surplus: FIEL estimates the primary surplus at US$ 9.8 billion, or about 3% of GDP (including the roughly US$ 4 billion in annual inflows to ANSES derived from the recent nationalized private pension funds, AFJPs, but excluding potential extra tax collection from the tax amnesty approved in Congress December 18). This is in line with Bein's estimate of US$ 10.2 billion, also about 3% of GDP (and again including AFJP flows), but lower than Kiguel's base case scenario of 3.5% of GDP. (It is noteworthy that all three analysts include the new ANSES/AFJP expected inflows as part of the primary surplus, even though in theory they belong to ANSES and the GoA can only access them via issuing debt to ANSES.)
-- Debt obligations: FIEL estimates the GoA's 2009 financial needs at US$ 19.9 billion, excluding short-term intra-public sector debt. The other two include such debt, which accounts for their higher estimates in the range of US$ 21 to 21.5 billion.
-- Debt repurchase: This is a required obligation stemming from the GoA's 2005 debt restructuring. FIEL estimates that the GoA must buy back US$ 1.7 billion in 2009, whereas Kiguel estimates it at US$ 2 billion and Bein estimates US$ 2.5 billion. All three expect the GoA to fulfill this requirement by rolling over ANSES holdings of GoA bonds.
-- Roll-over from ANSES: FIEL estimates the GoA will roll-over an additional US$ 1 billion in bonds, held originally by ANSES or by the AFJPs. This is slightly lower than Bein's estimate of US$ 1.4 billion and Kiguel's estimate of US$ 1.5 billion.
-- Financing Gap: FIEL estimates the resulting financing gap at US$ 3.2 billion. This assumes that the GoA will do a debt swap with local holders of the "Prestamos Garantizados" (PG -- guaranteed loans), thus reducing amortizations by US$ 2 billion in 2009. It also assumes the International Financial Institutions roll-over debts of $2.2 billion. Bein estimates a financing gap of only US$ 1.2 billion, assuming a PG swap resulting in reduced payments of US$ 2.6 billion and IFI refinancing of US$ 2.2 billion. Kiguel has a slightly higher estimate of US$ 3.5 billion financing gap, but this excludes the possibility of a PG swap or IFI refinancing. All three expect the GoA to cover the gap via borrowing from the Argentine Central Bank or largest state-owned bank, Banco de la Nacion.

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